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HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATED FINANCIAL STATEMENTS

AND

SUPPLEMENTARY INFORMATION

DECEMBER 31, 2007 AND 2006

CPAs / ADVISORS



HOWARD REGIONAL HEALTH SYSTEM

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REPORT OF INDEPENDENT AUDITORS

Board of Trustees
Howard Regional Health System
Kokomo, Indiana

We have audited the accompanying consolidated balance sheets of Howard Regional Health System (the System), as of December 31, 2007 and 2006, and the related consolidated statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of the Howard Regional Health System Foundation, Inc. (the Foundation), a blended component unit, whose statements reflect total assets of \$5,168,664 and \$5,347,363 as of December 31, 2007 and 2006, respectively, and total revenues of \$98,985 and \$267,543, respectively, for the years then ended. Those statements were audited by other auditors whose report has been furnished to us, and in our opinion, insofar as it relates to the amounts for the Foundation, is based solely on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards*, issued by the Comptroller General of the United States, Guidelines for Examination of Entities Receiving Financial Assistance From Governmental Sources and Guidelines for Audits of County and City Hospitals by Independent Certified Public Accountants issued by the Indiana State Board of Accounts. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits and the report of the other auditors provide a reasonable basis for our opinion.

Board of Trustees
Howard Regional Health System
Kokomo, Indiana

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above, present fairly, in all material respects, the consolidated financial position of the System as of December 31, 2007 and 2006 and the results of its consolidated operations, changes in net assets and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Management's discussion and analysis as listed in the accompanying table of contents, is not a required part of the basic consolidated financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consist principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were made for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The consolidating statements as listed in the accompanying table of contents are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have issued, under separate cover, our report dated May 19, 2008, on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in assessing the results of our audits.

Blue & Co., LLC

May 19, 2008

HOWARD REGIONAL HEALTH SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2007 AND 2006

This section of Howard Regional Health System's (the System) annual consolidated financial statements presents background information and management's discussion and analysis of the System's consolidated financial performance during the year ended December 31, 2007. This MD&A includes a discussion and analysis of the activities and results of the System, its blended component unit, Howard Regional Health System Foundation, and its majority owned subsidiaries as described in the notes to the consolidated financial statements.

This MD&A should be read together with the consolidated financial statements included in this report.

The System has two county-owned facilities and operates under the Indiana County Hospital Law, Indiana Code 16-22. It has a licensed and staffed 150-bed acute regional hospital and a 30-bed regional rehabilitation hospital both located in Kokomo, Indiana serving a nine county region in north central Indiana. The System provides short-term inpatient and outpatient health care among other services.

The Board of County Commissioners of Howard County appoints the Governing Board of the System and a financial benefit/burden relationship exists between the County and the System. For these reasons, the System is considered a component unit of Howard County.

HIGHLIGHTS OF THE YEAR ENDED DECEMBER 31, 2007

In late 2005, the Howard Regional Health System Board of Trustees approved a challenging three-year strategic plan that put into motion some very exciting opportunities for Howard. The strategic plan focused on four goals, some of which came to fruition in 2007:

1. Growing Volumes

Because the population of our primary service area is not expected to grow over the next five years, we plan to expand the geographic area we serve by moving more aggressively into the counties surrounding Howard County. In 2007, we continued investigating ways of doing this. Another strategy is to target the Medicare population. In order to be able to accommodate the increased number of patients this will bring to our System, we continue to look at ways to increase our current capacity.

2. Protecting and Enhancing Revenues

Partnering with our physicians and looking at procedures and specialties that bring in higher revenues are two of the strategies we continue to pursue in order to meet this goal.

HOWARD REGIONAL HEALTH SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2007 AND 2006

3. *Focusing on High End Services*

In addition to our new Emergency Department and our commitment to that service area, we have been looking at cardiology, neuro/stroke, gastro, general surgery, orthopedics and imaging. In some of these areas, we have already recruited top-level physicians and planned for needed technology and facilities.

4. *Enhancing Operations*

While we continue to provide high quality care, we are looking at ways to reduce our operating expenses. This is challenging, as we must also improve our infrastructure and invest in technology, both necessary to attract high caliber physicians and enhance the practices and productivity of our current physicians.

Strategic Initiatives Introduced in this Plan and Realized in 2007

Cardiology Service Enhancements

The System has provided accredited diagnostic cardiovascular services to our region for years. Investigating areas of need in North Central Indiana, we discovered that every year 300-350 patients from our service area who require cardiac surgery go to Indianapolis or other large cities for this. Projections showed that these numbers would continue to grow. (Also, in January 2006, the American College of Cardiology recommended on-site cardiac surgery for hospitals performing coronary interventions.)

After more than a year of planning, open heart surgery was introduced at the System in 2007. In addition to coronary artery bypass graft surgery, heart valve replacement and valve repair, our cardiothoracic surgeon also brought expertise in minimally invasive and traditional lobectomies and other lung surgeries, particularly for lung cancer.

Based on the success of the System's interventional cardiology program, the System was asked to be one of only six hospitals nationally to serve as a teaching site for a Boston Scientific iLab Intravascular Ultrasound (IVUS). The IVUS gives doctors the ability to see what angiogram Z-rays do not show – a 360 degree inside view of a patient's blood vessels. This view shows lesions and plaque deposits and allows for more precise measurement of vessel dimensions. It helps physicians effectively determine the information they need to perform angioplasty and place stents.

In developing our open heart program, the System made a commitment to the sophisticated technology it requires. As a result, the System was the first Indiana hospital to have the SPYTM Intra-operative Imaging System. SPY allows surgeons to see how well blood is flowing through a new graft so that necessary corrections can be made during the operation. Without this technology, surgeons must wait until after the

HOWARD REGIONAL HEALTH SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2007 AND 2006

surgery to determine whether grafts are successful. Unsuccessful grafts can lead to complications and repeat surgery.

Physician Recruitment

During 2007, we successfully recruited six physicians to the System's roster: Dr. Syed Hasan, psychiatry; Dr. Robert Kinsey, OB/GYN; Dr. Gerald Maesaka, family medicine; Dr. Soundos Moualla, interventional cardiology; Dr. David Sedaghat, internal medicine and pediatrics; and Dr. Ryan Trauring, internal medicine.

Facility Growth

Emergency Department

July 2007, we opened our new \$9.9 million, 27,655 square foot Emergency Department, significantly expanding the size and capabilities of this department. The new Emergency Department offers traditional emergency services as well as a 12-hour "fast track" area and 25 exam rooms. The new ED includes a private triage area, a spacious visitor's lounge with a canteen, and a children's play area.

Birthing Center and Medical/Surgical Unit

Work on our new Birthing Center and Medical/Surgical unit moved forward and opened early 2008, adding 29 private rooms: 13 medical/surgical rooms and the balance as additions to the Howard Regional Birthing Center.

Replay Physical Therapy

The early 2007 joint venture purchase of Replay Physical Therapy has expanded both inpatient and outpatient rehabilitation services and the System's continuum of care. Replay specializes in the treatment of orthopedic, neurological and sports-related injuries and has provided physical, occupational, speech and vocational rehabilitation from its two locations in Kokomo and Noblesville.

Imaging Center

The System took over operation of the Imaging Center on January 1, 2008. Doing so allowed us to begin offering inpatient MRI services at our Main Campus, addressing patient safety and quality of care issues and, at the same time, realize some operational efficiency. In addition to the outpatient services available at the Imaging Center, several concepts to expand the use of this facility for the continued growth of services important to our community are being discussed.

HOWARD REGIONAL HEALTH SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2007 AND 2006

QUALITY & SAFETY

The Centers for Medicare & Medicaid Services (CMS) has developed a set of core quality indicators to benchmark hospitals. The System participates in the reporting of this quality data to CMS on three patient populations: acute myocardial infarction (heart attack), congestive heart failure and pneumonia. We have also begun a surgical care improvement project.

During 2007, the System also joined with hospitals across the state to fulfill Governor Mitch Daniels' executive order mandating reporting of occurrences of any of 27 adverse medical events, most of which are preventable medical errors that result in death, serious disability or significant injury. The first report was published in March 2007. The System had no events to report.

The System joined the Institute for Healthcare Improvement's "Save 100,000 Lives" campaign in 2005, which focused on prevention of unnecessary deaths. By the time the campaign ended in July 2006, we had adopted all six of the IHI's safety measures. In December 2006, Howard made a commitment to be part of the IHI "Protecting Five Million Lives" campaign, which focuses on medically-induced injuries. The campaign will run until December 2008 and includes the following steps:

- Preventing pressure ulcers by reliably using science-based guidelines for prevention of this serious and common complication.
- Reducing Methicillin-Resistant Staphylococcus aureus (MRSA) infection through basic changes in infection control processes throughout the hospital.
- Preventing harm from high-alert medications starting with a focus on anticoagulants, sedatives, narcotics, and insulin.
- Reducing surgical complications by reliably implementing the changes in care recommended by the Surgical Care Improvement Project.
- Delivering reliable, evidence-based care for congestive heart failure to reduce readmission.
- Getting Boards on board so they can become more effective in accelerating the improvement of care.

LOOKING AHEAD TO 2008

We have recently broken ground for a medical office building adjacent to our West Campus Specialty Hospital. This facility, scheduled for completion in the fall of 2008, will house Kokomo Pulmonary and allow that growing practice to expand and add a physician later this year.

HOWARD REGIONAL HEALTH SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2007 AND 2006

We are also working on bringing the long-awaited Long Term Acute Care Hospital (LTACH) to our West Campus. This 26-bed facility is scheduled for completion in the fall of 2009.

Quality, patient safety and patient satisfaction will continue to be priorities at the System in the year and years ahead. Working with guidelines provided by many quality-based groups including Malcolm Baldrige, the Studer Group, CMS, IHI, Leapfrog and others, we are committed to providing exceptional quality care with compassion and respect for those we serve.

CONSOLIDATED FINANCIAL STATEMENTS

The System's consolidated financial statements consist of three statements - a consolidated balance sheet; a consolidated statement of operations and changes in net assets; and a consolidated statement of cash flows. The consolidated balance sheet includes all of the System's assets and liabilities, including assets held by the System but restricted for specific purposes by contributors, grantors, or enabling legislation. The consolidated balance sheet provides a basis for computing rate of return, evaluating the capital structure of the System, and assessing the liquidity and financial flexibility of the System. The consolidated statement of operations of changes in net assets includes all revenues and expenses of the System. This statement measures the consolidated financial results of the System's operations and presents revenue earned and expenses incurred. The consolidated statement of cash flows provides information about the System's cash flows from operating activities, capital and related financing activities, and investing activities, and provides information on the sources and uses of cash during the year.

HOWARD REGIONAL HEALTH SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2007 AND 2006

FINANCIAL PERFORMANCE

A summary of the System's consolidated statements of revenues, expenses and changes in net assets follows:

Summary of Operations	2007		2006	
	Amount	Ratio	Amount	Ratio
Total revenues	\$ 163,331,507	100.0%	\$ 149,582,051	100.0%
Salaries and benefits	81,262,901	49.8%	70,517,809	47.1%
Supplies and drugs	31,704,683	19.4%	28,170,169	18.8%
Purchased services	10,117,718	6.2%	9,692,415	6.5%
Depreciation and amortization	7,484,888	4.6%	6,621,901	4.4%
Other	27,057,468	16.6%	23,705,327	15.8%
Total operating expenses	157,627,658	96.5%	138,707,621	92.7%
Operating income	5,703,849	3.5%	10,874,430	7.3%
Nonoperating revenues (expenses), net and other changes in net assets	(2,693,532)	-1.6%	1,250,734	0.8%
Change in net assets	3,010,317	1.8%	12,125,164	8.1%
Net assets, beginning of year	85,532,113		73,406,949	
Net assets, end of year	\$ 88,542,430		\$ 85,532,113	

During 2007, the System derived substantially all of its revenue from patient services and other related activities. Revenue includes, among other items, revenue from the Medicare and Medicaid programs, patients, insurance carriers, preferred provider organizations, and managed care programs.

HOWARD REGIONAL HEALTH SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2007 AND 2006

Other financial performance indicators include:

Cash Flows Data

	2007	2006
From operating activities	\$ 6,802,812	\$ 16,501,642
From capital and related financing activities	\$ (25,431,072)	\$ (18,739,982)
From investing activities	\$ (1,173,954)	\$ (8,070,498)

Financial Position

Total assets	\$ 174,433,935	\$ 171,575,798
Net capital assets	\$ 84,931,207	\$ 70,307,741
Total liabilities	\$ 82,737,828	\$ 84,386,175
Long term debt, including current portion	\$ 62,777,717	\$ 64,323,452

Net assets

Invested in capital assets, net of related debt	\$ 28,571,067	\$ 30,111,727
Restricted for debt service	-0-	569,334
Expendable for capital improvements	8,472,795	8,096,304
Expendable for other specific purposes	12,440	11,715
Held by Foundation	3,533,785	3,434,800
Unrestricted	47,952,343	43,308,233
Total net assets	<u>\$ 88,542,430</u>	<u>\$ 85,532,113</u>

Days cash on hand

105	83
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Operating data

Number of staffed beds	180	180
Inpatient discharges	6,542	6,703
Average daily census	85.6	87.4
Acute average length of stay	4.3	4.1
Occupancy	57.1%	58.3%
Medicare inpatient case mix	1.44	1.35
Adjusted patient days	93,240	95,626

The System's revenues depend upon inpatient occupancy levels, the ancillary services and therapy programs ordered by physicians and provided to patients, the volume of outpatient procedures and the negotiated payment rates for such services. The gross charges typically do not reflect what is actually paid. The System has entered into agreements with third party payers, including government programs and managed care health plans, under which payments for healthcare services provided to patients are based upon predetermined rates per diagnoses or discounts from gross charges. The System receives a significant portion of its revenues from government health programs, principally Medicare and Medicaid, which are highly regulated and subject to frequent and substantial changes. Revenues from Medicare and Medicaid programs increased

HOWARD REGIONAL HEALTH SYSTEM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) DECEMBER 31, 2007 AND 2006

to 59.1% of gross revenues in 2007 from 55.2% in 2006. Legislative changes continue to limit or reduce the levels of payments from these programs.

The approximate percentages of gross patient revenues were:

	2007	2006
Medicare	48.2%	44.4%
Medicaid	10.9%	10.8%
Blue Cross/Blue Shield	16.1%	21.4%
Commercial	18.0%	17.4%
Other	6.8%	6.0%
	<u>100.0%</u>	<u>100.0%</u>

LONG TERM DEBT

As of December 31, 2007, the System had \$62.7 million in short term and long term notes and bonds outstanding, a decrease from the \$64.3 million as of December 31, 2006. The System restructured its debt and greatly increased its borrowings in 2005 to fund capital projects for the next several years and position the System for future growth. More detailed information about the System's long term debt is presented in the notes to the consolidated financial statements.

ECONOMIC OUTLOOK

Management believes that the healthcare industry operating margins will continue to be under significant pressure because of changes in payer mix and growth in operating expenses in excess of the increase in prospective payments under the Medicare and Medicaid programs. The ongoing challenge facing the System and the entire healthcare market is to continue to provide quality patient care in a competitive environment and to attain reasonable rates for the services it provides while managing its costs. The most significant cost factor affecting the System and the industry in general is the spiraling increase in labor costs due to a nationwide shortage of nurses and other healthcare specialists. The System expects the nursing shortage to continue and has implemented various initiatives to better position itself to attract and retain qualified nursing personnel and improve productivity.

CONTACTING THE SYSTEM'S FINANCIAL MANAGEMENT

This report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the System's finances and to show the System's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the System at 3500 South Lafountain Street, Kokomo, Indiana 46904, (765) 453-0702.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2007 AND 2006

ASSETS		
	2007	2006
Current assets		
Cash and cash equivalents	\$ 11,153,741	\$ 12,571,779
Investments	21,271,032	19,701,707
Patient accounts receivable, net of estimated uncollectibles of \$9,776,697 in 2007 and \$6,444,818 in 2006	23,236,941	23,627,937
Other receivables	2,980,747	4,170,463
Inventory and other current assets	5,371,841	4,565,879
Estimated third party settlements	5,997,457	703,156
Current portion of assets whose use is limited	800,000	905,000
Total current assets	70,811,759	66,245,921
Assets whose use is limited		
Internally designated	8,472,795	8,096,304
Held by trustee	6,513,975	24,791,404
Total assets whose use is limited	14,986,770	32,887,708
Less current portion	800,000	905,000
Noncurrent portion of assets whose use is limited	14,186,770	31,982,708
Capital assets, net	84,931,207	70,307,741
Other assets	4,504,199	3,039,428
Total assets	<u>\$ 174,433,935</u>	<u>\$ 171,575,798</u>

See accompanying notes to consolidated financial statements.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2007 AND 2006

LIABILITIES AND NET ASSETS

	2007	2006
Current liabilities		
Accounts payable and accrued expenses	\$ 6,476,384	\$ 7,646,500
Accrued liabilities	10,375,648	9,927,776
Other current liabilities	2,123,852	1,881,364
Current portion of loans payable	394,015	372,076
Current portion of revenue bonds payable	1,025,044	1,114,872
Total current liabilities	20,394,943	20,942,588
Long term debt		
Loans payable	11,362,864	11,815,666
Revenue bonds payable	49,995,794	51,020,838
Total long term debt	61,358,658	62,836,504
Other long term liabilities	984,227	607,083
Total liabilities	82,737,828	84,386,175
Minority interest	3,153,677	1,657,510
Net assets		
Invested in capital assets, net of related debt	28,571,067	30,111,727
Restricted		
For debt service	-0-	569,334
Expendable for capital improvements	8,472,795	8,096,304
Expendable for other specific purposes	12,440	11,715
Held by Foundation	3,533,785	3,434,800
Total restricted net assets	12,019,020	12,112,153
Unrestricted	47,952,343	43,308,233
Total net assets	88,542,430	85,532,113
Total liabilities and net assets	\$ 174,433,935	\$ 171,575,798

See accompanying notes to consolidated financial statements.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS YEARS ENDED DECEMBER 31, 2007 AND 2006

	2007	2006
Revenues		
Net patient service revenue	\$ 149,065,954	\$ 137,261,548
Other	14,265,553	12,320,503
Total revenues	163,331,507	149,582,051
Operating expenses		
Salaries and wages	65,960,300	56,264,029
Employee benefits	15,302,601	14,253,780
Medical professional fees	5,444,853	3,663,875
Medical supplies and drugs	31,704,683	28,170,169
Purchased services	10,117,718	9,692,415
Equipment rentals	7,154,997	5,801,464
Utilities and telephone	2,730,635	2,547,784
Insurance	1,073,165	1,016,228
Depreciation and amortization	7,484,888	6,621,901
Other	10,653,818	10,675,976
Total expenses	157,627,658	138,707,621
Operating income	5,703,849	10,874,430
Nonoperating revenues (expenses)		
Investment income	2,724,550	3,290,615
Interest expense	(2,082,089)	(1,401,271)
Other nonoperating expenses	(387,235)	(116,892)
Nonoperating revenues (expenses), net	255,226	1,772,452
Excess revenues over expenses before other changes in net assets	5,959,075	12,646,882
Other changes in net assets		
Unrealized gain (loss) on derivative	(1,132,195)	769,744
Minority interest	(1,816,563)	(1,291,462)
Other changes in net assets	(2,948,758)	(521,718)
Change in net assets	3,010,317	12,125,164
Net assets		
Beginning of year	85,532,113	73,406,949
End of year	\$ 88,542,430	\$ 85,532,113

See accompanying notes to consolidated financial statements.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2007 AND 2006

	2007	2006
Operating activities		
Cash received from patients and third party payors	\$ 144,162,649	\$ 133,574,832
Cash paid to vendors for goods and services	(67,805,755)	(61,999,606)
Cash paid for employee wages and benefits	(82,687,440)	(68,163,831)
Other receipts, net	13,133,358	13,090,247
Net cash flows from operating activities	6,802,812	16,501,642
Capital and related financing activities		
Acquisition and construction of capital assets	(21,947,954)	(16,623,663)
Gain/loss on disposal of property and equipment	144,706	280,797
Proceeds from long term debt	-0-	1,875,766
Interest on long term debt	(2,082,089)	(1,401,271)
Principal paid on long term debt	(1,545,735)	(2,871,611)
Net cash flows from capital and related financing activities	(25,431,072)	(18,739,982)
Investing activities		
Investment income	2,724,550	3,290,615
Investment in affiliated companies, net	(539,903)	(581,151)
Other nonoperating revenues and expenses	(387,235)	(116,892)
Minority interest	(1,816,563)	(1,152,697)
Other changes in investments and assets whose use is limited	(1,154,803)	(9,510,373)
Net cash flows from investing activities	(1,173,954)	(8,070,498)
Net change in cash and cash equivalents	(19,802,214)	(10,308,838)
Cash and cash equivalents, beginning of year	38,029,513	48,338,351
Cash and cash equivalents, end of year	<u>\$ 18,227,299</u>	<u>\$ 38,029,513</u>
Reconciliation of cash and cash equivalents		
In current assets	\$ 11,153,741	\$ 12,571,779
In investments	529,471	634,640
In assets whose use is limited - internally designated	30,112	31,960
In assets whose use is limited - held by trustee	6,513,975	24,791,134
Cash and cash equivalents, end of year	<u>\$ 18,227,299</u>	<u>\$ 38,029,513</u>

See accompanying notes to consolidated financial statements.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2007 AND 2006

	2007	2006
Reconciliation of operating income to net cash flows from operating activities		
Operating income	\$ 5,703,849	\$ 10,874,430
Adjustments to reconcile operating income to net cash flows from operating activities		
Depreciation and amortization	7,484,888	6,621,901
Bad debts	9,190,107	7,296,896
Changes in operating assets and liabilities		
Patient accounts receivable	(8,799,111)	(10,280,456)
Other receivables	1,189,716	(101,613)
Estimated third party settlements	(5,294,301)	(1,624,158)
Inventory and other assets	(1,938,157)	(123,905)
Accounts payable and accrued expenses	(1,424,539)	2,353,978
Accrued liabilities and other liabilities	447,872	1,321,598
Other current liabilities	242,488	162,971
Net cash flows from operating activities	<u>\$ 6,802,812</u>	<u>\$ 16,501,642</u>
Supplemental disclosures of cash flow information		
Cash paid for interest, net of capitalized interest of \$885,000 in 2007 and \$1,600,000 in 2006	<u>\$ 2,082,089</u>	<u>\$ 1,401,271</u>
Noncash capital and related financing activities		
Property purchases in accounts payable	<u>\$ 254,423</u>	<u>\$ 2,081,239</u>

See accompanying notes to consolidated financial statements.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Reporting Entity

Howard Regional Health System (the System) is a county-owned facility and operates under the Indiana County Hospital Law, Indiana Code 16-22. The System provides short-term inpatient and outpatient health care among other services. The Board of County Commissioners of Howard County appoints the Governing Board of the System and a financial benefit/burden relationship exists between the County and the System. For these reasons, the System is considered a component unit of Howard County.

Accounting principles generally accepted in the United States of America require that these consolidated financial statements present the System (primary government) and its significant component units. The component units discussed below are included in the System's reporting entity because of the significance of their operational or financial relationships with the System. Blended component units, although legally separate entities are in substance part of the government's operations and exist solely to provide services for the government; data from these units is combined with data of the primary government.

Blended Component Units

Howard Regional Health System Foundation, Inc. (the Foundation) is a blended component unit of the System. The Foundation is a separate not-for-profit entity organized to support the operations of the System. Financial statements for the Foundation can be obtained by contacting the Foundation office.

Other component units included in the consolidated financial statements based on the System's control of these entities are Howard Regional Specialty Care, LLC, Midwest Racquetball, Inc. dba Kokomo Sports Center and Howard Community Surgery Center, LLC. These entities have been consolidated for financial statement presentation.

All significant intercompany transactions have been eliminated in the consolidated financial statements.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

expenses during the reporting period. Actual results could differ from those estimates.

Enterprise Fund Accounting

The System utilizes the enterprise fund method of accounting whereby revenues and expenses are recognized on the accrual basis. Substantially all revenues and expenses are subject to accrual.

Accounting Standards

Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the System has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

Investments

Certificates of deposit, demand deposits and similar negotiable instruments that are not reported as cash and cash equivalents are reported as investments at cost or amortized cost which approximates fair value.

Mutual funds are reported at fair value based on the fund's market price. Other money market investments are reported at fair value.

Other investments are generally reported at fair value.

Investment income, including changes in the fair value of investments, is reported as nonoperating income in the consolidated statements of revenues, expenses and changes in net assets.

Patient Accounts Receivable and Revenues

Patient revenues and the related accounts receivable are recorded at the time services to patients are performed. The System is a provider of services to patients entitled to coverage under Titles XVIII and XIX of the Health Insurance Act (Medicare and Medicaid). The System is reimbursed for Medicare and Medicaid inpatient services based on a fixed price per discharge for each diagnosis related grouping (DRG). The System is reimbursed for Medicare and Medicaid outpatient services based on a fixed price per clinical unit of service. Differences between the total program billed charges and the payments received are reflected as deductions from revenue. At the System's year-end, a cost report is filed with the Medicare

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program computing reimbursement amounts related to Medicare patients. The difference between computed reimbursement and interim reimbursement is reflected as a receivable from or payable to the third-party program. These programs have audited the year-end cost report filed with the Medicare program through December 31, 2005 with differences reflected as deductions from revenue in 2007. During 2007 and 2006, the System recognized approximately \$93,000 and \$341,000, respectively, to income due to the differences between original estimates and subsequent revisions for the final settlement of cost reports.

Management estimates an allowance for uncollectible patient accounts receivable based on an evaluation of historical losses, current economic conditions, and other factors unique to the System's customer base.

Charity Care

The System provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the System does not collect amounts deemed to be charity care, they are not reported as revenue.

Inventory

Inventory is valued at the lower of cost or market with cost being determined on the first-in, first-out (FIFO) method.

Assets Whose Use is Limited

Assets whose use is limited are stated at fair market value in the consolidated financial statements. These assets include investments designated by the System's Board of Trustees for internal purposes, investments restricted by donors for a specific purpose and investments held by trustees for debt service and capital expenditures. These investments consist primarily of cash and cash equivalents, certificates of deposit, US government securities and mutual funds. Investment interest, dividends, gains and losses, both realized and unrealized are included in nonoperating revenues (expenses) in the consolidated statements of revenues, expenses and changes in net assets.

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Capital Assets and Depreciation

Capital assets such as property and equipment are stated at cost and include expenditures for new additions and other costs added to existing facilities which exceed \$500 and meet certain useful life thresholds. Maintenance, repairs and minor renewals are expensed as incurred. The System provides for depreciation of property and equipment using annual rates, which are sufficient to depreciate the cost of depreciable assets over their estimated useful lives using the straight-line method. The range of useful lives in computing depreciation is as follows:

<u>Description</u>	<u>Range of Useful Lives</u>
Land improvements	15 years
Buildings and fixed equipment	4-50 years
Major moveable equipment	5-15 years

Net Assets

Net assets of the System are classified in three components. Net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted net assets are noncapital net assets that must be used for a particular purpose, as specified by creditors or donors outside the System, including amounts deposited with trustees as required by revenue bond indentures, amounts designated for capital improvements and net assets held by the Foundation. Unrestricted net assets are remaining net assets that do not meet the definition of net assets invested in capital assets net of related debt or restricted net assets.

Consolidated Statements of Revenues, Expenses and Changes in Net Assets

The System's consolidated statements of revenues, expenses and changes in net assets distinguish between operating and nonoperating revenues and expenses. For purposes of display, transactions deemed by management to be ongoing, major or central to the provision of healthcare services are reported as revenues and expenses. Peripheral or incidental transactions such as investment activities are reported as nonoperating gains or losses.

Consolidated Statements of Cash Flows

For the purposes of the consolidated statements of cash flows, cash and cash equivalents include demand deposits and investments in highly liquid debt instruments with an original maturity date of three months or less from the date of purchase. Capitalized interest expense was \$885,000 and \$1,600,000 for 2007 and

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2006, respectively. Capitalized interest income was \$591,000 and \$1,326,000 for 2007 and 2006, respectively.

Cost of Borrowing

Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Bond Issue Costs

The System provides for the amortization of costs incurred for the issuance of bonds over the life of the debt. Bond issue costs net of accumulated amortization were \$656,701 and \$706,217 as of December 31, 2007 and 2006, respectively.

Fair Value of Financial Instruments

Financial instruments consist of cash and cash equivalents, patient accounts receivable, assets whose use is limited, accounts payable, accrued liabilities, estimated third-party settlements and long-term debt. The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, patient accounts receivable, accounts payable, accrued liabilities and estimated third-party settlements approximate fair value.

The fair values of assets whose use is limited are estimated based on quoted market prices for those or similar investments. The fair value of the System's long-term debt is estimated based on market prices for similar issues on current rates offered to the System. As of December 31, 2007 and 2006, the carrying value of the System's long-term debt approximated its fair value.

Federal or State Income Taxes

The System is exempt from taxation as a not-for-profit organization under the Internal Revenue Code as an extension of the county government and, therefore, no provision for income taxes has been made.

Compensated Absences

The System's policy on compensated absences (which include vacation, sick leave and holidays) allows full time employees and regular part time employees to accrue days off, to a maximum of 480 hours. Compensated absences are accrued when incurred and reported as a liability on the consolidated balance sheets.

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Advertising Costs

The System's policy is to expense advertising costs when the advertising first takes place. Advertising expenses were \$1,205,442 and \$1,089,209 in 2007 and 2006, respectively.

Litigation

The System is involved in litigation arising in the normal course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the System's future financial position or results from operations.

Risk Management

The System is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters.

Medical Malpractice Claims

The System participates in the Indiana Medical Malpractice Act which limits the maximum recovery to \$1,250,000 per occurrence, the first \$250,000 of which would be the responsibility of the System, with the balance paid by the State of Indiana Patient Compensation Fund. The System carries an occurrence basis insurance policy covering the System's \$250,000 of exposure per claim. Accordingly, the System has not recorded any provision of self-insured medical malpractice claims.

Reclassifications

Certain amounts from the 2006 financial statements have been reclassified to conform to the current year presentation. Certain 2006 elimination amounts were reclassified resulting in a change to the 2006 consolidated net assets of approximately \$139,000. There were no changes in the individual net assets of the System or its affiliates as of December 31, 2006 only in the consolidated reporting.

2. NET PATIENT SERVICE REVENUE

The System has agreements with third-party payors that provide for reimbursement to the System at amounts different from its established rates. Estimated contractual adjustments under third-party reimbursement programs represent the difference between the System's billings at standard rates and amounts reimbursed by third-party payors. They also include any differences between estimated third-party

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reimbursement settlements for prior years and subsequent final settlements. A summary of the reimbursement arrangements with major third-party payors is as follows:

Medicare

Medicare inpatient services are reimbursed based on a predetermined amount for each case based on the diagnosis associated with the patient (Prospective Payment Hospital). These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. The prospectively determined rates are not subject to retroactive adjustment. The System's classification of patients under the Prospective Payment Hospital and the appropriateness of patient admissions are subject to validation reviews by the Medicare peer review organization which is under contract with the System to perform such reviews. Medicare outpatient services are primarily reimbursed on predetermined rates based on the services provided.

Medicaid

The System is reimbursed for Medicaid inpatient services under a prospectively determined rate-per-discharge and is not subject to retroactive adjustment. The differences between standard charges and reimbursement from these programs are recorded as contractual adjustments. Reimbursement for Medicaid outpatient services is based on predetermined rates, and is not subject to retroactive cost based settlements.

The System is eligible for the Indiana Medicaid Supplemental programs including Medicaid Disproportionate Share Hospital and Municipal Upper Payment Limit programs. The System recognized reimbursement from these programs within net patient revenue of approximately \$9,333,000 and \$3,253,000 during 2007 and 2006, respectively. These programs are Federal programs administered by the state.

Other Payors

The System also has entered into payment agreements with certain commercial insurance carriers and preferred provider organizations. The basis for payment to the System under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

The following is a summary of net patient service revenue for 2007 and 2006:

	2007	2006
Inpatient routine services	\$ 40,274,624	\$ 37,280,743
Inpatient ancillary services	78,064,765	72,038,264
Outpatient ancillary services	201,241,759	181,283,749
Gross patient service revenue	319,581,148	290,602,756
Contractual allowance	154,498,014	140,576,996
Charity care	6,827,073	5,467,316
Bad debts	9,190,107	7,296,896
Deductions from revenue	170,515,194	153,341,208
Net patient service revenue	<u>\$ 149,065,954</u>	<u>\$ 137,261,548</u>

3. CHARITY CARE

The System maintains records to identify and monitor the level of charity care it provides. These records include the amount of services and supplies furnished under its charity care policy. Charity care provided was \$6,827,073 and \$5,467,316 for 2007 and 2006, respectively.

4. INVESTMENTS

Investments are recorded at fair value and consist of the following as of December 31:

	2007	2006
Cash and cash equivalents	\$ 529,471	\$ 634,640
Mutual funds - equity	12,148,170	12,911,261
Mutual funds - fixed income	8,593,391	6,155,806
	<u>\$ 21,271,032</u>	<u>\$ 19,701,707</u>

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

5. ASSETS WHOSE USE IS LIMITED

The classification of assets whose use is limited includes:

Internally designated - Amounts transferred by the System's Board of Trustees through funding depreciation expense. Such amounts are to be used for equipment and building, remodeling, repairing, replacing or making additions to the System buildings as authorized by IC 16-22-3-13.

Funds held by trustee - System funds deposited with a trustee and limited as to use in accordance with the requirements of a trust indenture for debt service and capital construction.

Assets whose use is limited that are required for obligations classified as current liabilities are reported in current assets. The composition of assets limited as to use includes the following as of December 31:

	<u>2007</u>	<u>2006</u>
Internally designated		
Cash and cash equivalents	\$ 30,112	\$ 31,960
Mutual funds - equity	4,968,801	5,360,698
Mutual funds - fixed income	3,473,882	2,703,916
	<u>8,472,795</u>	<u>8,096,574</u>
Held by trustee		
Cash and cash equivalents	<u>6,513,975</u>	<u>24,791,134</u>
Total assets whose use is limited	<u>\$ 14,986,770</u>	<u>\$ 32,887,708</u>

6. DEPOSITS AND INVESTMENTS

Deposits with financial institutions in the State of Indiana at year end were entirely insured by the Federal Depository Insurance Corporation or by the Indiana Public Deposit Insurance Fund. This includes any deposit accounts issued or offered by a qualifying financial institution.

Investments are carried at fair market value. Net realized gains and losses on security transactions are determined on the specific identification cost basis. Funded depreciation investments consist of cash equivalents and mutual funds. Market value approximated cost as of December 31, 2007 and 2006.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

The System's investments generally are reported at fair value, as discussed in Note 1. As of December 31, 2007 and 2006, the System had the following investments and maturities, all of which were held in the System's name by custodial banks that are agents of the System:

December 31, 2007

	Carrying Amount	Investment Maturities (in years)			
		Less than 1	1-5	6-10	More than 10
Mutual funds - equity	\$ 17,116,971	\$ 17,116,971	\$ -0-	\$ -0-	\$ -0-
Mutual funds - fixed income	12,067,273	12,067,273	-0-	-0-	-0-
	<u>\$ 29,184,244</u>	<u>\$ 29,184,244</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>

December 31, 2006

	Carrying Amount	Investment Maturities (in years)			
		Less than 1	1-5	6-10	More than 10
Mutual funds - equity	\$ 18,271,959	\$ 18,271,959	\$ -0-	\$ -0-	\$ -0-
Mutual funds - fixed income	8,859,722	8,859,722	-0-	-0-	-0-
	<u>\$ 27,131,681</u>	<u>\$ 27,131,681</u>	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ -0-</u>

Interest rate risk – The System does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from changing interest rates.

Credit risk – Statutes authorize the System to invest in interest bearing deposit accounts, passbook savings accounts, certificates of deposit, money market accounts, mutual funds, pooled fund investments, securities backed by the full faith and credit of the United States Treasury and repurchase agreements. The statutes require that repurchase agreements be fully collateralized by U.S. Government or U.S. Government Agency obligations.

Concentration of credit risk – The System maintains its investments, which at times may exceed federally insured limits. The System has not experienced any losses in such accounts. The System believes that it is not exposed to any significant credit risk on investments.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

Deposits and investments consist of the following as of December 31:

	2007	2006
Carrying amount		
Deposits	\$ 18,227,299	\$ 38,029,513
Mutual funds - equity	17,116,971	18,271,959
Mutual funds - fixed income	12,067,273	8,859,722
	<u>\$ 47,411,543</u>	<u>\$ 65,161,194</u>
Included in the balance sheet captions		
Cash and cash equivalents	\$ 11,153,741	\$ 12,571,779
Investments	21,271,032	19,701,707
Internally designated	8,472,795	8,096,304
Held by trustee	6,513,975	24,791,404
	<u>\$ 47,411,543</u>	<u>\$ 65,161,194</u>

7. CAPITAL ASSETS

A summary of capital assets includes the following as of December 31:

	December 31 2006	Additions	Retirements	Transfers	December 31 2007
Land	\$ 644,187	\$ -0-	\$ -0-	\$ -0-	\$ 644,187
Land improvements	2,295,002	334,223	(6,540)	576,545	3,199,230
Buildings and improvements	69,384,756	325,066	(33,305)	10,257,426	79,933,943
Equipment	43,642,488	3,152,655	(2,482,587)	6,642,390	50,954,946
Construction in progress	16,075,668	18,390,433	(86,196)	(17,476,361)	16,903,544
Total capital assets	132,042,101	22,202,377	(2,608,628)	-0-	151,635,850
Less accumulated depreciation					
Land improvements	1,045,261	203,122	(5,804)	-0-	1,242,579
Buildings and improvements	31,840,283	2,867,639	(31,041)	-0-	34,676,881
Equipment	28,848,816	4,363,444	(2,427,077)	-0-	30,785,183
Total accumulated depreciation	61,734,360	7,434,205	(2,463,922)	-0-	66,704,643
Capital assets, net	<u>\$ 70,307,741</u>	<u>\$ 14,768,172</u>	<u>\$ (144,706)</u>	<u>\$ -0-</u>	<u>\$ 84,931,207</u>

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

	December 31 2005	Additions	Retirements	Transfers	December 31 2006
Land	\$ 644,187	\$ -0-	\$ -0-	\$ -0-	\$ 644,187
Land improvements	2,274,008	125,857	(2,632)	(102,231)	2,295,002
Buildings and improvements	67,045,094	107,956	(329,371)	2,561,077	69,384,756
Equipment	39,834,129	3,632,443	(629,305)	805,221	43,642,488
Construction in progress	4,501,089	14,838,646	-0-	(3,264,067)	16,075,668
Total capital assets	114,298,507	18,704,902	(961,308)	-0-	132,042,101
Less accumulated depreciation					
Land improvements	898,521	149,288	(2,548)	-0-	1,045,261
Buildings and improvements	29,384,749	2,778,495	(322,961)	-0-	31,840,283
Equipment	25,509,700	3,694,118	(355,002)	-0-	28,848,816
Total accumulated depreciation	55,792,970	6,621,901	(680,511)	-0-	61,734,360
Capital assets, net	<u>\$ 58,505,537</u>	<u>\$ 12,083,001</u>	<u>\$ (280,797)</u>	<u>\$ -0-</u>	<u>\$ 70,307,741</u>

8. LONG TERM DEBT

The System has the following bond issues outstanding with the Indiana Health Facility Financing Authority (IHFFA) and other local financial institutions as of December 31, 2007 and 2006:

- 1997 IHFFA Revenue Bonds, original issue \$6,800,000, paid off during 2007.
- 2005 IHFFA Revenue Bonds, original issue \$50,000,000, due through January 2035, variable interest rate of 3.51% as of December 31, 2007, secured by letters of credit in the amounts of approximately \$50,000,000 expiring through August 2010.
- 2006 IHFFA Revenue Bonds, original issue \$1,875,766, due through January 2013, variable interest rate of 4.79% as of December 31, 2007, secured by a letter of credit in the amount of approximately \$1,400,000 expiring in August 2008.
- Loans payable with local financial institutions, due through 2026 at fixed interest rates at 5.82% as of December 31, 2007, secured by certain System assets.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

A summary of long term debt for 2007 and 2006 follows:

	December 31 2006	Borrowings	Payments	December 31 2007	Current Portion
Revenue bonds					
1997 IHFFA Bonds	\$ 600,000	\$ -0-	\$ (600,000)	\$ -0-	\$ -0-
2005 IHFFA Bonds	50,000,000	-0-	(305,000)	49,695,000	800,000
2006 IHFFA Bonds	1,535,710	-0-	(209,872)	1,325,838	225,044
Total revenue bonds	52,135,710	-0-	(1,114,872)	51,020,838	1,025,044
Loans payable	12,187,742	-0-	(430,863)	11,756,879	394,015
Total long term debt	<u>\$ 64,323,452</u>	<u>\$ -0-</u>	<u>\$ (1,545,735)</u>	<u>\$ 62,777,717</u>	<u>\$ 1,419,059</u>

	December 31 2005	Borrowings	Payments	December 31 2006	Current Portion
Revenue bonds					
1997 IHFFA Bonds	\$ 1,200,000	\$ -0-	\$ (600,000)	\$ 600,000	\$ 600,000
2005 IHFFA Bonds	50,000,000	-0-	-0-	50,000,000	305,000
2006 IHFFA Bonds	-0-	1,875,766	(340,056)	1,535,710	209,872
Total revenue bonds	51,200,000	1,875,766	(940,056)	52,135,710	1,114,872
Loans payable	14,119,297	-0-	(1,931,555)	12,187,742	372,076
Total long term debt	<u>\$ 65,319,297</u>	<u>\$ 1,875,766</u>	<u>\$ (2,871,611)</u>	<u>\$ 64,323,452</u>	<u>\$ 1,486,948</u>

Maturities for the years subsequent to December 31, 2007 are as follows:

Years Ending December 31,	Principal	Interest	Total
2008	\$ 1,419,059	\$ 2,463,290	\$ 3,882,349
2009	1,445,250	2,401,987	3,847,237
2010	1,520,645	2,404,985	3,925,631
2011	1,593,674	2,337,398	3,931,072
2012	1,669,509	2,266,019	3,935,527
2013-2017	7,799,065	10,325,482	18,190,094
2018-2022	9,743,018	8,429,289	18,172,308
2023-2027	12,767,496	6,013,517	18,781,013
2028-2032	14,675,000	3,432,713	18,107,713
2033-2035	10,145,000	743,138	10,888,138
	<u>\$ 62,777,717</u>	<u>\$ 40,817,817</u>	<u>\$ 103,661,081</u>

The bonds require the System to maintain certain financial ratios and restrictive covenants. As of December 31, 2007 and 2006, the System was in compliance with the financial ratios and covenants. The System has construction contract commitments of approximately \$6 million and \$25 million outstanding as of December 31, 2007 and 2006, respectively.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

The System has an interest rate swap agreement related to the 2005 Revenue Bonds.

The System has lines of credit with local financial institutions. The lines bear interest at rates ranging from a fixed rate of 5% to a variable rate of prime less .25% and expire on demand. There were no borrowings outstanding on the lines of credit as of December 31, 2007 and 2006.

9. DERIVATIVE LIABILITY

During the year ended December 31, 2005, the System entered into two "cash flow hedge interest rate swap" agreements with a financial institution. The System pays a fixed interest rate (3.55% as of December 31, 2007 and 2006) and the financial institution pays a variable interest rate (3.51% and 4.05 % as of December 31, 2007 and 2006, respectively) over the term of the agreements.

The System's objective is to provide protection against market driven increases in variable interest rates. The fair value of each agreement was determined by the financial institution using the present value of the estimated projected cash flows. The System is in a liability position as of December 31, 2007 and an asset position as of December 31, 2006, due to the present value of its estimated projected cash flows being less than the financial institution's present value of estimated projected cash flows.

The first swap was effective on October 3, 2005 and matures on January 1, 2035. It contains an outstanding notional amount of \$30,000,000 with a 3.55% fixed rate of interest and is a derivative liability for the System with a fair value as of December 31, 2007 of \$646,787 and a derivative asset as of December 31, 2006 of \$202,323.

The second swap was effective on October 3, 2005 and matures on January 1, 2035. It contains an outstanding notional amount of \$10,000,000 with a 3.55% fixed rate of interest and is a derivative liability for the System with a fair value as of December 31, 2007 of \$215,565 and a derivative asset as of December 31, 2006 of \$67,520.

The unrealized loss on derivative for 2007 was \$1,132,195. The unrealized gain on derivative for 2006 was \$769,744. The asset (liability) is only receivable (payable) upon termination of the agreements by the System. The asset is recorded in other assets and the liability is in other long term liabilities on the consolidated balance sheets.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

10. PENSION PLAN

The System has a defined contribution pension plan as authorized by IC 16-22-3-11. The plan provides retirement, disability and death benefits to plan members and beneficiaries. The plan was established by written agreement between the System's Board of Trustees and the plan administrator. The plan administrator issues a publicly available financial report that includes financial statements and required supplementary information of the plan. Contact the System's human resource department for information on the plan.

Total pension expense for 2007 and 2006 was \$3,099,327 and \$2,895,277, respectively. The current employer contribution rate is 8% of annual covered payroll.

11. COMMITMENTS AND CONTINGENCIES

Operating Leases

Leases that do not meet the criteria for capitalization are classified as operating leases with related rentals charged to operations as incurred. Leases expire through 2012. Total rental expense in 2007 and 2006 for all operating leases was \$3,643,868 and \$3,206,336, respectively.

Minimum payments under operating lease agreements for the years subsequent to December 31, 2007 are as follows:

<u>Years Ending December 31,</u>	
2008	\$ 1,253,103
2009	1,134,021
2010	439,810
2011	291,552
2012	27,500
	<u>\$ 3,145,986</u>

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

12. CONCENTRATIONS

The System grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third party payors as of December 31, 2007 and 2006 was as follows:

	2007	2006
Medicare	34%	33%
Medicaid	11%	8%
Blue Cross	14%	17%
Other third party payors	14%	15%
Self-pay	27%	27%
	<u>100%</u>	<u>100%</u>

The blended component units of the System maintain cash in accounts, which at times may exceed federally insured limits. The blended component units have not experienced any losses in such accounts. The blended component units believe that it is not exposed to any significant credit risk on cash and cash equivalents.

13. INVESTMENTS IN AFFILIATED COMPANIES

North Central Indiana Linen Service, Inc.

The System owns 33% of North Central Indiana Linen Service. The investment is accounted for under the equity method. Summarized financial information as of December 31 follows:

	2007	2006
Assets	\$ 1,115,995	\$ 1,263,118
Liabilities	261,392	498,837
Equity	854,603	764,281
Revenue	1,608,894	1,594,695
Expenses	1,480,977	1,449,389
Net income	127,917	145,306

Imaging Center of North Central Indiana

The System entered into an agreement with St. Joseph's Hospital, DCNHS of Kokomo, Indiana, and established the Imaging Center of North Central Indiana, a 501(c)(3) corporation, whose exempt purpose is the provision of magnetic imaging

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

services to the residents of the Kokomo area. Howard Regional Health System and Saint Joseph's Hospital were equal corporate members as of December 31, 2007 and 2006. The investment is recorded on the equity method. Summarized financial information as of December 31 follows:

	2007	2006
Assets	\$ 7,021,213	\$ 8,530,337
Liabilities	5,101,507	6,313,931
Equity	1,919,706	2,216,406
Revenue	5,190,339	5,263,630
Expenses	5,487,039	5,353,759
Net loss	(296,700)	(90,129)

Effective January 1, 2008, the System acquired 100% ownership of the Imaging Center of North Central Indiana.

Kokomo LTACH, LLC

In December 2007, the System invested \$210,000 for 35% ownership in Kokomo LTACH, LLC to operate a long-term acute care hospital in Kokomo, Indiana. There was no financial activity for Kokomo LTACH, LLC in 2007 other than the capitalization of the entity.

14. PHYSICIAN RELOCATION AGREEMENTS AND OTHER MINIMUM REVENUE GUARANTEES

Consistent with the System's policy on physician relocation and recruitment, the System provides income guarantee agreements to certain physicians who agree to relocate to the community to fill a need in the System's service area and commit to remain in practice there. Under such agreements, the System is required to make payments to the physicians in excess of the amounts they earn in their practice up to the amount of the income guarantee. The income guarantee periods are typically one to three years. Such payments are recoverable from the physicians if they do not fulfill their commitment period to the community, which is typically three years. The System also provides minimum revenue collection guarantees to System-based physician groups providing certain services at the System with terms ranging from one to three years. As of December 31, 2007, the maximum potential amount of future payments under these guarantees was approximately \$250,000.

HOWARD REGIONAL HEALTH SYSTEM

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2007 AND 2006

In accordance with FASB Staff Position FIN 45-3, "Application of FASB Interpretation No. 45 to Minimum Revenue Guarantees Granted to a Business or Its Owners," as of December 31, 2007 and 2006, the System recorded a liability of approximately \$122,000 and \$607,000, respectively, for the fair value of new or modified guarantees entered into with an offsetting asset recorded in other assets on the accompanying balance sheet, which will be amortized over the commitment period.

15. SELF FUNDED HEALTH INSURANCE

The System is self funded for medical and related health benefits provided to employees and their families. A stop/loss policy through commercial insurance covers individual claims in excess of \$100,000 per year. Provisions are made for unexpected and unusual claims.

Claim expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported. Self funded health insurance and related expenses were \$6,407,823 and \$6,855,835 in 2007 and 2006, respectively. A progression of unpaid claims for 2007 and 2006 follows:

	<u>2007</u>	<u>2006</u>
Unpaid claims, beginning of year	\$ 1,300,742	\$ 1,151,614
Incurred claims and changes in estimates	6,407,823	6,855,835
Claim payments	<u>(6,545,676)</u>	<u>(6,706,707)</u>
Unpaid claims, end of year	<u>\$ 1,162,889</u>	<u>\$ 1,300,742</u>

SUPPLEMENTARY INFORMATION

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2007

	ASSETS						
	Howard Regional Health System	HRHS Foundation	Howard Regional Specialty Care	Kokomo Sports Center	Howard Community Surgery Center	Eliminations	Total
Current assets							
Cash and cash equivalents	\$ 7,372,348	\$ 611,033	\$ 1,024,026	\$ 67,164	\$ 2,079,170	\$ -0-	\$ 11,153,741
Investments	18,292,726	2,978,306	-0-	-0-	-0-	-0-	21,271,032
Patient accounts receivable, net	21,804,564	-0-	1,432,377	-0-	-0-	-0-	23,236,941
Other receivables	2,690,056	-0-	0	35,136	1,719,788	(1,464,233)	2,980,747
Inventory and other current assets	4,899,627	-0-	206,223	0	265,991	-0-	5,371,841
Estimated third party settlements	5,997,457	-0-	-0-	-0-	-0-	-0-	5,997,457
Current portion of assets whose use is limited	800,000	-0-	-0-	-0-	-0-	-0-	800,000
Total current assets	61,856,778	3,589,339	2,662,626	102,300	4,064,949	(1,464,233)	70,811,759
Assets whose use is limited							
Internally designated	8,472,795	-0-	-0-	-0-	-0-	-0-	8,472,795
Held by trustee	6,417,577	96,398	-0-	-0-	-0-	-0-	6,513,975
Total assets whose use is limited	14,890,372	96,398	-0-	-0-	-0-	-0-	14,986,770
Less current portion of assets whose use is limited	800,000	-0-	-0-	-0-	-0-	-0-	800,000
Noncurrent portion of assets whose use is limited	14,090,372	96,398	-0-	-0-	-0-	-0-	14,186,770
Capital assets, net	83,144,746	391	532,560	723,995	529,515	-0-	84,931,207
Other assets	7,142,967	1,482,536	865,922	-0-	-0-	(4,987,226)	4,504,199
Total assets	\$ 166,234,863	\$ 5,168,664	\$ 4,061,108	\$ 826,295	\$ 4,594,464	\$ (6,451,459)	\$ 174,433,935

Assets whose use is limited
Internally designated
Held by trustee
Total assets whose use is limited
Less current portion of assets whose use is limited
Noncurrent portion of assets whose use is limited

Capital assets, net
Other assets

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2007

LIABILITIES AND NET ASSETS

	Howard Regional Health System	HRHS Foundation	Howard Regional Specialty Care	Kokomo Sports Center	Howard Community Surgery Center	Eliminations	Total
Current liabilities							
Accounts payable and accrued expenses	\$ 5,882,606	\$ -0-	\$ 447,323	\$ 936,252	\$ 585,196	\$ (1,374,993)	\$ 6,476,384
Accrued liabilities	9,752,873	-0-	622,775	-0-	-0-	-0-	10,375,648
Other current liabilities	1,763,248	309,041	92,408	102,547	-0-	(143,392)	2,123,852
Current portion of loans payable	394,015	-0-	-0-	-0-	-0-	-0-	394,015
Current portion of capital lease payable	225,044	-0-	-0-	-0-	-0-	(225,044)	-0-
Current portion of revenue bonds payable	800,000	225,044	-0-	-0-	-0-	-0-	1,025,044
Total current liabilities	18,817,786	534,085	1,162,506	1,038,799	585,196	(1,743,429)	20,394,943
Long term debt							
Loans payable	11,428,411	-0-	-0-	37,000	-0-	(102,547)	11,362,864
Capital lease payable	1,100,794	-0-	-0-	-0-	-0-	(1,100,794)	-0-
Revenue bonds payable	48,895,000	1,100,794	-0-	-0-	-0-	-0-	49,995,794
Total long term debt	61,424,205	1,100,794	-0-	37,000	-0-	(1,203,341)	61,358,658
Other long term liabilities							
Total liabilities	81,226,218	1,634,879	1,162,506	1,075,799	585,196	(2,946,770)	82,737,828
Minority interest	-0-	-0-	-0-	-0-	-0-	3,153,677	3,153,677
Net assets							
Invested in capital assets, net of related debt	26,719,059	(1,325,447)	532,560	686,995	529,515	1,428,385	28,571,067
Restricted							
Expendable for capital improvements	8,472,795	-0-	-0-	-0-	-0-	-0-	8,472,795
Expendable for other specific purposes	12,440	-0-	-0-	-0-	-0-	-0-	12,440
Held by Foundation	-0-	3,533,785	-0-	-0-	-0-	-0-	3,533,785
Total restricted net assets	8,485,235	3,533,785	-0-	-0-	-0-	-0-	12,019,020
Unrestricted	49,804,351	1,325,447	2,366,042	(936,499)	3,479,753	(8,086,751)	47,952,343
Total net assets	85,008,645	3,533,785	2,898,602	(249,504)	4,009,268	(6,658,366)	88,542,430
Total liabilities and net assets	\$ 166,234,863	\$ 5,168,664	\$ 4,061,108	\$ 826,295	\$ 4,594,464	\$ (6,451,459)	\$ 174,433,935

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATING STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS YEAR ENDED DECEMBER 31, 2007

	Howard Regional Health System	HRHS Foundation	Howard Regional Specialty Care	Kokomo Sports Center	Howard Community Surgery Center	Eliminations	Total
Revenues							
Net patient service revenue	\$ 124,875,328	\$ -0-	\$ 13,333,620	\$ -0-	\$ 10,857,006	\$ -0-	\$ 149,065,954
Other	14,372,498	41,216	658,817	438,427	-0-	(1,245,405)	14,265,553
Total revenues	139,247,826	41,216	13,992,437	438,427	10,857,006	(1,245,405)	163,331,507
Operating expenses							
Salaries and wages	56,606,612	-0-	6,833,513	-0-	2,520,175	-0-	65,960,300
Employee benefits	13,588,575	-0-	1,714,026	-0-	-0-	-0-	15,302,601
Medical professional fees	4,698,023	-0-	726,717	20,113	-0-	-0-	5,444,853
Medical supplies and drugs	27,960,071	-0-	936,288	35,542	2,772,782	-0-	31,704,683
Purchased services	8,174,794	-0-	1,104,213	513,092	508,418	(182,799)	10,117,718
Equipment rentals	5,899,198	-0-	1,173,918	38,383	1,067,598	(1,024,100)	7,154,997
Utilities and telephone	2,280,793	-0-	376,321	45,407	28,114	-0-	2,730,635
Insurance	958,243	-0-	64,737	12,383	37,802	-0-	1,073,165
Depreciation and amortization	7,007,766	-0-	205,540	85,223	186,359	-0-	7,484,888
Other	10,031,274	-0-	211,306	61,664	349,574	-0-	10,653,818
Total expenses	137,205,349	-0-	13,346,579	811,807	7,470,822	(1,206,899)	157,627,658
Operating income (loss)	2,042,477	41,216	645,858	(373,380)	3,386,184	(38,506)	5,703,849
Nonoperating revenues (expenses)							
Investment income	2,402,792	235,747	-0-	377	85,634	-0-	2,724,550
Interest expense	(2,120,595)	-0-	-0-	-0-	-0-	38,506	(2,082,089)
Other nonoperating revenues (expenses)	1,718,853	(177,978)	(927)	-0-	-0-	(1,927,183)	(387,235)
Nonoperating revenues (expenses), net	2,001,050	57,769	(927)	377	85,634	(1,888,677)	255,226
Excess revenues over expenses before other changes in net assets	4,043,527	98,985	644,931	(373,003)	3,471,818	(1,927,183)	5,959,075
Other changes in net assets							
Unrealized loss on derivatives	(1,132,195)	-0-	-0-	-0-	-0-	-0-	(1,132,195)
Minority interest	-0-	-0-	-0-	-0-	-0-	(1,816,563)	(1,816,563)
Member contributions	-0-	-0-	2,687,404	80,879	-0-	(2,768,283)	-0-
Member distributions	-0-	-0-	-0-	-0-	(2,919,114)	2,919,114	-0-
Other changes in net assets	(1,132,195)	-0-	2,687,404	80,879	(2,919,114)	(1,665,732)	(2,948,758)
Change in net assets	2,911,332	98,985	3,332,335	(292,124)	552,704	(3,592,915)	3,010,317
Net assets							
Beginning of year	82,097,313	3,434,800	(433,733)	42,620	3,456,564	(3,065,451)	85,532,113
End of year	\$ 85,008,645	\$ 3,533,785	\$ 2,898,602	\$ (249,504)	\$ 4,009,268	\$ (6,658,366)	\$ 88,542,430

See report of independent auditors on pages 1 and 2.

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2006

	ASSETS						Total
	Howard Regional Health System	HRHS Foundation	Howard Regional Specialty Care	Kokomo Sports Center	Howard Community Surgery Center	Eliminations	
Current assets							
Cash and cash equivalents	\$ 11,123,665	\$ 538,551	\$ 82,785	\$ 10,668	\$ 816,110	\$ -0-	\$ 12,571,779
Investments	16,793,506	2,908,201	-0-	-0-	-0-	-0-	19,701,707
Patient accounts receivable, net	22,519,718	-0-	1,108,219	-0-	-0-	-0-	23,627,937
Other receivables	3,678,419	-0-	-0-	25,031	2,636,837	(2,169,824)	4,170,463
Inventory and other current assets	4,172,369	-0-	176,014	14,972	202,524	-0-	4,565,879
Estimated third party settlements	646,974	-0-	56,182	-0-	-0-	-0-	703,156
Current portion of assets whose use is limited	905,000	-0-	-0-	-0-	-0-	-0-	905,000
Total current assets	59,839,651	3,446,752	1,423,200	50,671	3,655,471	(2,169,824)	66,245,921
Assets whose use is limited							
Internally designated	8,096,304	-0-	-0-	-0-	-0-	-0-	8,096,304
Held by trustee	24,696,772	94,632	-0-	-0-	-0-	-0-	24,791,404
Total assets whose use is limited	32,793,076	94,632	-0-	-0-	-0-	-0-	32,887,708
Less current portion of assets whose use is limited	905,000	-0-	-0-	-0-	-0-	-0-	905,000
Noncurrent portion of assets whose use is limited	31,888,076	94,632	-0-	-0-	-0-	-0-	31,982,708
Capital assets, net	68,704,108	493	474,611	601,919	526,610	-0-	70,307,741
Other assets	4,396,928	1,805,486	-0-	-0-	-0-	(3,162,986)	3,039,428
Total assets	\$ 164,828,763	\$ 5,347,363	\$ 1,897,811	\$ 652,590	\$ 4,182,081	\$ (5,332,810)	\$ 171,575,798

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATING BALANCE SHEETS DECEMBER 31, 2006

	LIABILITIES AND NET ASSETS						Total
	Howard Regional Health System	HRHS Foundation	Howard Regional Specialty Care	Kokomo Sports Center	Howard Community Surgery Center	Eliminations	
Current liabilities							
Accounts payable and accrued expenses	\$ 6,361,745	\$ -0-	\$ 2,046,591	\$ 466,530	\$ 725,517	\$ (1,953,883)	\$ 7,646,500
Accrued liabilities and other	9,674,627	-0-	253,149	-0-	-0-	-0-	9,927,776
Other current liabilities	1,747,706	376,853	31,804	106,440	-0-	(381,439)	1,881,364
Current portion of loans payable	372,076	-0-	-0-	-0-	-0-	-0-	372,076
Current portion of capital lease payable	209,872	-0-	-0-	-0-	-0-	(209,872)	-0-
Current portion of revenue bonds payable	905,000	209,872	-0-	-0-	-0-	-0-	1,114,872
Total current liabilities	19,271,026	586,725	2,331,544	572,970	725,517	(2,545,194)	20,942,588
Long term debt							
Loans payable	11,815,666	-0-	-0-	37,000	-0-	(37,000)	11,815,666
Capital lease payable	1,342,675	-0-	-0-	-0-	-0-	(1,342,675)	-0-
Revenue bonds payable	49,695,000	1,325,838	-0-	-0-	-0-	-0-	51,020,838
Total long term debt	62,853,341	1,325,838	-0-	37,000	-0-	(1,379,675)	62,836,504
Other long term liabilities							
Total liabilities	82,731,450	1,912,563	2,331,544	609,970	725,517	(3,924,869)	84,386,175
Minority interest	-0-	-0-	-0-	-0-	-0-	1,657,510	1,657,510
Net assets							
Invested in capital assets, net of related debt	28,491,257	(1,535,217)	474,611	564,919	526,610	1,589,547	30,111,727
Restricted							
For debt service	569,334	-0-	-0-	-0-	-0-	-0-	569,334
Expendable for capital improvements	8,096,304	-0-	-0-	-0-	-0-	-0-	8,096,304
Expendable for other specific purposes	11,715	-0-	-0-	-0-	-0-	-0-	11,715
Held by Foundation	-0-	3,434,800	-0-	-0-	-0-	-0-	3,434,800
Total restricted net assets	8,677,353	3,434,800	-0-	-0-	-0-	-0-	12,112,153
Unrestricted	44,928,703	1,535,217	(908,344)	(522,299)	2,929,954	(4,654,998)	43,308,233
Total net assets	82,097,313	3,434,800	(433,733)	42,620	3,456,564	(3,065,451)	85,532,113
Total liabilities and net assets	\$ 164,828,763	\$ 5,347,363	\$ 1,897,811	\$ 652,590	\$ 4,182,081	\$ (5,332,810)	\$ 171,575,798

HOWARD REGIONAL HEALTH SYSTEM

CONSOLIDATING STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS YEAR ENDED DECEMBER 31, 2006

	Howard Regional Health System	HRHS Foundation	Howard Regional Specialty Care	Kokomo Sports Center	Howard Community Surgery Center	Eliminations	Total
Revenues							
Net patient service revenue	\$ 117,904,067	\$ -0-	\$ 9,451,767	\$ -0-	\$ 9,905,714	\$ -0-	\$ 137,261,548
Other	13,142,472	74,517	21,030	484,435	-0-	(1,401,951)	12,320,503
Total revenues	131,046,539	74,517	9,472,797	484,435	9,905,714	(1,401,951)	149,582,051
Operating expenses							
Salaries and wages	50,547,414	-0-	3,335,307	-0-	2,381,308	-0-	56,264,029
Employee benefits	13,419,906	-0-	833,874	-0-	-0-	-0-	14,253,780
Medical professional fees	2,212,246	-0-	1,431,892	19,737	-0-	-0-	3,663,875
Medical supplies and drugs	24,716,125	-0-	800,346	30,623	2,623,075	-0-	28,170,169
Purchased services	6,838,406	-0-	2,179,180	430,166	459,663	(215,000)	9,692,415
Equipment rentals	5,249,487	-0-	747,787	25,220	892,047	(1,113,077)	5,801,464
Utilities and telephone	2,197,363	-0-	272,006	44,942	33,473	-0-	2,547,784
Insurance	894,576	-0-	68,683	16,320	36,649	-0-	1,016,228
Depreciation and amortization	6,037,893	-0-	143,787	64,859	375,362	-0-	6,621,901
Other	10,141,303	-0-	152,478	77,575	304,620	-0-	10,675,976
Total expenses	122,254,719	-0-	9,965,340	709,442	7,106,197	(1,328,077)	138,707,621
Operating income (loss)	8,791,820	74,517	(492,543)	(225,007)	2,799,517	(73,874)	10,874,430
Nonoperating revenues (expenses)							
Investment income	2,870,360	361,486	-0-	72	58,697	-0-	3,290,615
Interest expense	(1,475,145)	-0-	-0-	-0-	-0-	73,874	(1,401,271)
Other nonoperating revenues (expenses)	1,010,092	(168,460)	-0-	-0-	-0-	(958,524)	(116,892)
Nonoperating revenues (expenses), net	2,405,307	193,026	-0-	72	58,697	(884,650)	1,772,452
Excess revenues over expenses before other changes in net assets	11,197,127	267,543	(492,543)	(224,935)	2,858,214	(958,524)	12,646,882
Other changes in net assets							
Unrealized gain on derivatives	769,744	-0-	-0-	-0-	-0-	-0-	769,744
Minority interest	-0-	-0-	-0-	-0-	-0-	(1,291,462)	(1,291,462)
Member contributions	(109,251)	-0-	109,251	-0-	-0-	-0-	-0-
Member distributions	-0-	-0-	-0-	-0-	(3,868,500)	3,868,500	-0-
Other changes in net assets	660,493	-0-	109,251	-0-	(3,868,500)	2,577,038	(521,718)
Change in net assets	11,857,620	267,543	(383,292)	(224,935)	(1,010,286)	1,618,514	12,125,164
Net assets							
Beginning of year	70,239,693	3,167,257	(50,441)	267,555	4,466,850	(4,683,965)	73,406,949
End of year	\$ 82,097,313	\$ 3,434,800	\$ (433,733)	\$ 42,620	\$ 3,456,564	\$ (3,065,451)	\$ 85,532,113

See report of independent auditors on pages 1 and 2.